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No. 5

# In the Supreme Court of the United States

OCTOBER TERM, 1945

STATE OF NEW YORK AND SARATOGA SPRINGS COMMISSION AND SARATOGA SPRINGS AUTHORITY, PETITIONERS

*v.*

UNITED STATES OF AMERICA

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## SUPPLEMENTAL BRIEF FOR THE UNITED STATES ON REHEARING

# INDEX

## CITATIONS


Cases:

| | Page |
|---|---|
| *Allen* v. *Regents of the University System of Georgia*, 304 U. S. 439 | 2 |
| *Amalgamated Society of Engineers* v. *Adelaide Steamship Co.*, 28 C. L. R. 129 | 16 |
| *Baker* v. *Commissioner*, 149 F. 2d 342, certiorari denied, October 8, 1945 | 16 |
| *Board of Trustees* v. *United States*, 289 U. S. 48 | 7, 10 |
| *California* v. *Anglim*, 129 F. 2d 455, certiorari denied, 317, U. S. 665 | 11 |
| *Cleveland* v. *United States*, 323 U. S. 329 | 13 |
| *Coleman* v. *Miller*, 307 U. S. 433 | 15 |
| *Collector* v. *Day*, 11 Wall. 113 | 7, 8 |
| *Flint* v. *Stone Tracy Co.*, 220 U. S. 107 | 16 |
| *Georgia* v. *Stanton*, 6 Wall. 50 | 15 |
| *Graves* v. *New York ex rel. O'Ke[illegible]* 306 U. S. 466 | 15 |
| *Helvering* v. *Gerhardt*, 304 U. S. 405 | 6, 15 |
| *Helvering* v. *Powers*, 293 U. S. 214 | 2, 5, 6 |
| *Kentucky* v. *Dennison*, 24 How. 66 | 15 |
| *Mayo* v. *United States*, 319 U. S. 441 | 13 |
| *Murray* v. *Wilson Distilling Company*, 213 U. S. 151 | 5 |
| *Ohio* v. *Akron Park District*, 281 U. S. 74 | 15 |
| *Ohio* v. *Helvering*, 292 U. S. 360 | 2, 5, 6 |
| *Puget Sound Power and Light Company* v. *Seattle*, 291 U. S. 619 | 16 |
| *Smith* v. *Davis*, 323 U. S. 111 | 13 |
| *South Carolina* v. *United States*, 199 U. S. 437 | 2, 3, 4, 5, 6 |
| *United States* v. *Allegheny County*, 322 U. S. 174 | 3, 7, 13 |
| *United States* v. *California*, 297 U. S. 175 | 2, 6, 9 |

Statutes:

| | |
|---|---|
| Act of August 5, 1861, 12 Stat. 292 | 17 |
| Internal Revenue Code: | |
| Sec. 1808 | 17 |
| Sec. 2406 | 17 |
| Sec. 2551 | 17 |
| Sec. 2700 | 17 |




674461—45——1

Statutes—Continued

Internal Revenue Code—Continued Page

Sec. 2721 17
Sec. 3222 17
Sec. 3262 17
Sec. 3411 17
Sec. 3466 17
Sec. 3469 17
Sec. 3475 17
Sec. 3540 17

Miscellaneous:

Altmeyer, *Social Security for State and Local Government Employees*, Social Security Bulletin, April 1945, p. 2 11
G. C. M. 14407, XIV–1 Cum. Bull. 103 17
Powell, *The Remnant of Intergovernmental Tax Immunities*, 58 Harv. L. Rev. 757, 795 15

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## SUPPLEMENTAL BRIEF FOR THE UNITED STATES ON REHEARING

On October 8, 1945, the Court entered an order herein requesting counsel, "without restricting their argument in any other respect", to consider the following questions:

1. May Congress constitutionally include for taxation in a generally applicable taxing act any state property or activity or the income derived by the state from them, or any other source, so long as the tax does not discriminate against the state, or so long as the tax is not laid on the interest taxed, merely because it is that of a state—and if income of a private person from a like source may be constitutionally taxed?

2. To what extent may a state, by enlarging its property ownership or its activities, withdraw from the reach of the federal taxing power property and income which are normally subject to federal taxation when owned or received by private persons? See *United States* v. *California*, 297 U. S. 175, 184, 185, and cases cited.

We think that the answer to the first question is yes, and to the second that a state may not to any extent so withdraw property and income from the reach of the federal taxing power. Since the second question suggests a more moderate limitation of the doctrine of immunity than does the first question, we shall deal with it at the outset.

## I

In our original brief we maintained that this case comes squarely within the scope of *South Carolina* v. *United States*, 199 U. S. 437, and the cases which have followed it. *Ohio* v. *Helvering*, 292 U. S. 360; *Helvering* v. *Powers*, 293 U. S. 214; *Allen* v. *Regents of the University System of Georgia*, 304 U. S. 439. Those cases made it clear, in our view, that the immunity doctrine, even in the broadest scope to which it has ever been extended, does not apply to state activities of the character here involved.

We pointed out that any limitation on the federal taxing power other than those contained in the Constitution itself—that direct taxes shall be levied according to population and that indirect

taxes shall be uniform—rests on implication; that the doctrine of immunity of states from federal taxation has been deemed to rest on the necessity of preserving our dual form of Government; and that in accommodating the express power of national taxation and the asserted immunity, the latter must not be carried beyond the necessity which alone has given rise to its implication. We sought to show that the principle of the *South Carolina* case was a relatively early recognition of this practical need for limiting the immunity doctrine so that in the name of protection against the destruction of state governments the taxing power of the National Government would not itself be impaired or destroyed. An appropriate limitation of the immunity doctrine had been particularly called for, we insisted, because immunity founded on an assumed constitutional basis is irremediable by Congress, whereas taxability as a matter of constitutional law leaves open the conferring of exemption by act of Congress in which the states are represented, and "which also is their Congress," *United States* v. *Allegheny County*, 322 U. S. 174, 191. Thus the principle of the *South Carolina* case, from which there has been no departure in the whole history of the judicial treatment of immunity, stands as a recognition of the perils of immunity, a recognition that long antedated the notable series of decisions by which this Court has retreated from the immunity doctrine in numerous additional aspects.

While admittedly the appellations "governmental" and "proprietary" may be inapt to express the limitation in the *South Carolina* case and succeeding cases, a limitation was nonetheless imperative, in somewhat the same sense that state courts have found a similar limitation imperative to place bounds on the rule of state and municipal immunity in tort. The real question is whether any immunity whatever should be retained, or whether, as New York has done in the case of tort liability (see Pet. Br. on reargument, p. 43, n.), the remnant of immunity should be abandoned. That question we discuss below. At this point we shall not repeat the argument in our original brief, to which we adhere, that under any classification of activities which is appropriate as a qualification of immunity, or, to put it otherwise, as an accommodation of the federal revenue power and the preservation of the states, the sale of bottled mineral water throughout half the country in active competition with private brands is not shielded by the Constitution from a non-discriminatory federal tax.[1]

[1] We dealt in our original brief with the state's contention that the disposal of a natural resource is not within the scope of the *South Carolina* case (see our brief, pp. 23–24). Apart from questions of the meaning of "natural resource" and the point at which processing of a commodity goes beyond mere disposal, the suggested category would introduce for constitutional purposes a curious distinction between the extractive industries on the one hand and agriculture or manufacturing on the other. The state now apparently substi-

The second question put by the Court focuses attention on a significant factor supporting the principle of the *South Carolina* case. That case was explained in *Murray* v. *Wilson Distilling Company*, 213 U. S. 151, 173, as "concerned with the power of a State, by virtue of its legislation in regard to the sale and consumption of liquor, to destroy a preexisting right of taxation possessed by the Government of the United States." We do not understand that under this reasoning it would be necessary to show that the precise excise tax in question was levied prior to the state's embarking upon the enterprise in question, and in any event a tax like that here involved was so levied (Pet. Br. on Rearg., p. 48).

This Court has observed that the sovereign taxing

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tutes for natural resources the broader concept of "public services" (Brief on reargument, p. 42). It is not clear why the sale of alcoholic liquor by a state dispensary, or the furnishing of street car transportation, would not be a public service, thus invalidating rather than distinguishing the decisions in the *South Carolina*, *Ohio*, and *Powers* cases. In any event, very few business enterprises, those carried on by private no less than public agencies, today forego description as "public services." The Court will not, we believe, seek to resolve constitutional issues by importing a phrase having an ominous resemblance to "business affected with a public interest."

Nor does it seem helpful to point out (Pet. Br. on reargument, p. 20) that the bottled mineral water is not suitable for use in conjunction with alcoholic liquors. The question whether the mineral waters can be legally assimilated to alcoholic beverages does not depend upon whether the two may be palatably mixed in a glass.

power "would be unduly curtailed if either by extending its activities could withdraw from the taxing power of the other subjects of taxation traditionally within it." *United States* v. *California*, 297 U. S. 175, 184, citing *Helvering* v. *Powers*, *supra*; *Ohio* v. *Helvering*, *supra*; and *South Carolina* v. *United States*, *supra*, all cases dealing with federal taxation of state activities. Again, it was said in *Helvering* v. *Gerhardt*, 304 U. S. 405, 417:

> * * * But if every federal tax which is laid on some new form of state activity, or whose economic burden reaches in some measure the state or those who serve it, were to be set aside as an infringement of state sovereignty, it is evident that a restriction upon national power, devised only as a shield to protect the states from curtailment of the essential operations of government which they have exercised from the beginning, would become a ready means for striking down the taxing power of the nation. See *South Carolina* v. *United States*, 199 U. S. 437, 454–455.

The latter passage puts the principle in terms both of "essential" operations of government and historic performance by the state. The important point is that if a non-discriminatory federal tax is forbidden to be laid on a state activity lest the coexistence of the states be threatened, the area of such immunity should be kept at a minimum, for the immunity can only be rationalized as growing out of an abundance

of caution; and as caution and the activities of the state become more and more abundant the sources of federal revenue and the scope for congressional adjustment of competing interests become more paltry.

## II

Probably no more unfortunate chapter in the history of constitutional adjudication can be found than the rise and decline of the doctrine of implied immunity of state instrumentalities from federal taxation. Many applications of the doctrine have now been rectified by the overruling of decisions, including that in *Collector* v. *Day*, 11 Wall. 113, in which the doctrine took its origin.[2] The guiding principle in limiting the doctrine of immunity has been that it rests, as has been stated above, on an implied necessity to preserve the existence of the states, and "Springing from that necessity it does not extend beyond it." *Board of Trustees* v. *United States*, 289 U. S. 48, 59. The question remains whether the Court should not move full circle and disavow the necessity for the doctrine, save as it may protect states against exactions which are discriminatory or which are laid on them because they are states. This is the substance of the first question put by the Court.

When the doctrine of immunity of state instrumentalities was announced in 1870 in *Collec-*

[2] See the cases cited in *United States* v. *Allegheny County*, 322 U. S. 174, 177, n. 2.

*tor* v. *Day*, Mr. Justice Bradley expressed this disagreement and these apprehensions (11 Wall. at 128–129):

> I cannot accede to the doctrine that the general government is to be regarded as in any sense foreign or antagonistic to the State governments, their officers, or people; nor can I agree that a presumption can be admitted that the general government will act in a manner hostile to the existence or functions of the State governments, which are constituent parts of the system or body politic forming the basis on which the general government is founded. The taxation by the State governments of the instruments employed by the general government in the exercise of its powers, is a very different thing. Such taxation involves an interference with the powers of a government in which other States and their citizens are equally interested with the State which imposes the taxation. In my judgment, the limitation of the power of taxation in the general government, which the present decision establishes, will be found very difficult of control. Where are we to stop in enumerating the functions of the State governments which will be interfered with by Federal taxation? If a State incorporates a railroad to carry out its purposes of internal improvement, or a bank to aid its financial arrangements, reserving, perhaps, a percentage on the stock or profits, for the supply of its own treasury, will the bonds

> or stock of such an institution be free from Federal taxation? How can we now tell what the effect of this decision will be? I cannot but regard it as founded on a fallacy, and that it will lead to mischievous consequences. I am as much opposed as any one can be to any interference by the general government with the just powers of the State governments. But no concession of any of the just powers of the general government can easily be recalled. I, therefore, consider it my duty to at least record my dissent when such concession appears to be made. An extended discussion of the subject would answer no useful purpose.

The subsequent history of the doctrine has amply confirmed the soundness of Justice Bradley's position. If anything made clear by the evolution of the doctrine, it is that it was misconceived as a means of preserving the existence of the states and has served to curtail the legitimate demands of the National Government. It is anomalous to single out the non-discriminatory taxing power of the Federal Government as inherently a peculiar threat to the existence of the states, and consequently a power from which certain state functions are immune, while at the same time sustaining the application of nondiscriminatory Federal regulatory measures of all sorts to the states and state-conducted enterprises. Cf. *United States* v. *California*, 297 U. S. 175.

The anomaly is illustrated by comparing customs duties and internal revenue taxes as applied to the states. During the long period when customs duties provided our principal source of national revenue, it apparently occurred to no one that to lay the duties on the states as importers was a constitutionally forbidden threat to the existence and functions of the states. Not until a very recent date was there a challenge to this familiar subjection of the states to the obligation to pay a federal tax. "It is sufficient to say that only in recent years has any question been raised by state officials as to the authority of Congress to impose duties upon their imports." *Board of Trustees* v. *United States*, 289 U. S. 48, 60. It is true that the obligation to pay was there sustained on the reasoning that tariff duties are a form of regulation of commerce, to which states are subject uniformly with others; but no good reason is perceived why a different approach should be taken when the impost is laid solely under the taxing power. The Constitution does not classify the powers of the National Government in a hierarchy of importance. It would be unwarranted to infer that uniformity in the imposition of customs duties is more vital than uniformity in the imposition of internal revenue taxes. Excise taxes, like customs duties, are levied on carefully chosen subjects, with a view not merely to the collection of revenue but to the effect on the econ-

omy and on competition. Immunities introduce distortions in the Congressional design in either case.

Another illustration may be ventured, in the field of social security taxation. The Carriers Taxing Act, providing a system of retirement pensions for railroad workers, may be validly applied to a state as employer, whether on the ground that it represents an exercise of the commerce power or that the activity of the state falls within the South Carolina case. *California* v. *Anglim*, 129 F. 2d 455 (C. C. A. 9), certiorari denied, 317 U. S. 669. Where the employment is not of a similar character, does the Constitution forbid inclusion of employment by the state as a subject of social security taxation? Must the state's payroll as a measure of the tax be winnowed so that, for example, the employer's tax may embrace a clerk or carpenter when he works in the railroad or liquor department but not when he works in the division of parks or archives?[3] Social security taxation rests on the unity and continuity of a human life and the fluidity of employment.

[3] The problem is not academic. In connection with proposals to enlarge the coverage of the Federal Social Security Act, the Chairman of the Social Security Board has estimated that about half of the state and local government employees, or one and a half million workers, are not covered by retirement systems. See Altmeyer, *Social Security for State and Local Government Employees*, Social Security Bulletin, April 1945, p. 4.

Surely to make the cessation and resumption of coverage depend on changes in employment of the kind indicated would have as serious effect on the aims of social security legislation as immunity of the states from customs duties would have had on the objectives of the tariff, and with as little relation to the maintenance of the states.

From the standpoint, too, of benefit and protection conferred by the taxing authority, there is no basis for state immunity. Apart from direct financial outlays such as grants in aid, the National Government obviously confers important benefits on the states no less than on private persons. This is particularly evident where the state is in competition, as here, with private enterprise. The benefit of federal administration of trade-mark and unfair-competition legislation, pure food and drug laws, adequate and economical interstate transportation, and all the host of governmental safeguards for business enterprises, operate in the interest of the state no less than of its taxpaying competitors.

There remains to be considered the argument of reciprocity. To this argument there are several answers. In the first place, as pointed out in our original brief (p. 22), no rule of reciprocity has been thought to exist in the field of regulation, or of condemnation, or of priority of debts. In the second place, true reciprocity is not achieved by conferring absolute immunity on

state activities. Such a reciprocity is more verbal than real. This is true because in the converse field, that of taxation of federal activities by the states, Congress has power, which it has freely exercised, to permit taxation of federal activities by the states. (See our original brief, pp. 19–21.) There is no similar opportunity for Congressional action if immunity of the states is established as a constitutional principle. Reciprocity is a problem not of verbal formulas but of practical adjustments. That is to say, it is a legislative problem.

The Court seems clearly to have come to this view with respect to the question of the validity of state taxation in its relation to the Federal Government. There is an area within which immunity for the Federal Government is implied from the Constitution, but Congress has the power to waive even that immunity. *United States* v. *Allegheny County*, 322 U. S. 174, 189–191; *Mayo* v. *United States*, 319 U. S. 441, 446. On the other hand, many decisions recognize the power of Congress to extend the federal immunity beyond the limits within which it would be implied from the Constitution. *Mayo* v. *United States, supra; Smith* v. *Davis*, 323 U. S. 111, 114, fn. 4, 115; *Cleveland* v. *United States*, 323 U. S. 329, 333; see also the dissenting opinion of Mr. Justice Frankfurter in *United States* v. *Allegheny County, supra*, p. 196. This leaves Congress free to consider the numer-

ous, varied and complex factors which must necessarily enter into the determination of such a problem, to consider the burdens and benefits flowing from immunity *vel non*, and to strike a balance between the needs of state and nation—a balance which, because of the flexibility of the legislative process, may be adjusted from time to time to reflect changes in the underlying factors. The judgment thus reached is one made by a body representative of each and all of the states so that it constitutes, in a very real sense, the judgment of the states themselves.

We respectfully submit that the same approach should characterize the judicial treatment of the other aspect of the immunity problem—the relationship of state and nation with respect to the effects of a federal tax. This, too, is in its essentials a legislative problem which needs resolution by the national legislature in each instance, for it requires an appraisal of factors of the same nature as are involved in the problem of federal immunity—an appraisal which is not properly part of the judicial function. And Congress should manifestly have the broadest possible area within which to act.[4]

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[4] "Reciprocity between the states and the nation is essential to offset or to minimize one of the evils of the immunity doctrine." Yet it may be suggested that in observing the balance between state and nation, consideration should be given to the heavy national expenditures for what used to be deemed primary state concerns and to the state compensations from sales and gross receipts taxes and from inclusion of federal

The truth is that the preservation of the states by immunity from non-discriminatory taxation has been an *ignis fatuus* which has led nowhere but to confusion, collision and retreat. It may be ventured that nothing would have been lost and much gained if the courts had treated the problem from the beginning as a political question. Cf. *Georgia* v. *Stanton*, 6 Wall. 50; *Kentucky* v. *Dennison*, 24 How. 66; *Ohio* v. *Akron Park District*, 281 U. S. 74, 79–80; *Coleman* v. *Miller*, 307 U. S. 433, 450–456.

In any event we submit that the only federal tax which could lend itself as a means of achieving the destruction of the states, and therefore the only federal tax which in any circumstances should ever be held to be constitutionally prohibited, is one which would discriminate against the states as states. Thus a tax which either in form or effect singled out the privilege of being governor of a state, or judge in a state court of record, or the convening of state legislatures, might be the kind of a tax which could be used as a device to terminate the existence of the states. But a non-discriminatory income tax which the governor and the judge must pay in common with all the other citizens of the country, does not involve any such danger. *Helvering* v. *Gerhardt*, 304 U. S. 405; *Graves* v. *New York ex*

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bond interest in the measure of corporate excises." See Powell, *The Remnant of Intergovernmental Tax Immunities*, 58 Harv. L. Rev. 757, 795.

*rel. O'Keefe*, 306 U. S. 466; *Baker* v. *Commissioner*, 149 F. 2d 342 (C. C. A. 4), certiorari denied, October 8, 1945. Any non-discriminatory tax on state property or a state activity or state income would be no greater threat.

Unless the tax is one which singles out the basic functions which are inherent in the concept of a state and which only a state can perform, it does not constitute a menace to the continued existence of the states. This was the thought in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 158, when the Court referred to "The exercise of such rights as the establishment of a judiciary, the employment of officers to administer and execute the laws" as illustrative of the state functions which cannot be reached by the federal taxing power. This was also the thought of Higgins, J., of Australia, in *Amalgamated Society of Engineers* v. *Adelaide Steamship Co.*, 28 C. L. R. 129, 170, quoted on page 16 of our original brief.

The petitioners observe that states have pioneered in many fields of public control and public ownership. No one would detract one iota from the achievements of the states in this regard. No one would deny the right of a state to subsidize such endeavors by tax exemption from local taxation or by other means. *Puget Sound Power and Light Company* v. *Seattle*, 291 U. S. 619. No one would deny the right of Congress to exempt such endeavors of a state from federal

taxation, as has been done, for example, in the case of publicly owned power plants.[5] But our question is whether the Constitution requires Congress and the people of all the other states to subsidize such endeavors by granting immunity from taxes laid on comparable private endeavors or income. A judgment whether or not to confer such a subsidy is one upon which the people of all the other states are entitled to have a voice, and they may have that voice only if it is recognized that the problem is one for Congress. Each state is left free to determine for itself the desirability of engaging in a particular activity. But it may not by unilateral action require the Federal Government,

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[5] Section 3411, Int. Rev. Code, imposes a tax on the sale of electrical energy for domestic or commercial consumption. Subsection (c) provides: "No tax shall be imposed under this section upon electrical energy sold to the United States or to any State or Territory, or political subdivision thereof, or the District of Columbia. None of the provisions of this section shall apply to publicly owned electric and power plants, or to electric and power plants or systems owned and operated by cooperative or nonprofit corporations engaged in rural electrification. * * *"

The states enjoy numerous exemptions under the Internal Revenue Code. E. g., Sec. 1808 (a) (documents tax); Sec. 2406 (retailers excise taxes); Sections 2551 (c) and 3222 (b) (narcotics taxes); Sections 2700 (b) (1), 2721 and 3262 (firearms taxes); Section 3466 (a) (communications taxes); Sections 3469 (f) and 3475 (b) (transportation tax); Section 3540 (j) (use tax on motor vehicles and boats). The Federal income tax is construed administratively as not applying to the states. G. C. M. 14407, XIV–1 Cum. Bull. 103.

The Civil War apportioned tax on land exempted state-owned property. 12 Stat. 292, 297, c. 45, sec. 13.

and therefore the other states, to bear a part of the cost of the enterprise in the form of tax exemption.

It is our position that the Constitution is neutral, as it is silent, on the question of state ownership; that such ownership may be, but need not be, given special treatment in general federal revenue laws as in federal regulatory laws; and that such ownership or activities are protected by virtue of the Constitution only against hostile or discriminatory treatment by the National Government.

## CONCLUSION

The judgment below should be affirmed.

Respectfully submitted.

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